Nos. 22277, 22277A and 22277B

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

No. 22277

ESTATE OF BERNARD H. STAUFFER, BONNIE H. STAUFFER, EXECUTRIX,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

No. 22277A

ESTATE OF BERNARD H. STAUFFER, BONNIE H. STAUFFER, EXECUTRIX,

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Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Petitions for Review of the Decisions of the Tax Court of the United States.

PETITIONER'S REPLY BRIEF.

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THE "F" REORGANIZATION ISSUE.

I.

Respondent's Brief Contains a Number of Fundamental Concessions.

Although Respondent may dispute the legal conclusions arrived at by Petitioner in her Opening Brief, Respondent concedes most of the foundational points which underlie those conclusions. The major points which Respondent concedes to be correct (either expressly or by inference) are as follows:

1. The operating loss carryback would have been undeniably available had the relevant transactions been structured in any one of various other ways.

2. The basic philosophy underlying the *Libson Shops*[1] decision, as to the purpose of the loss carryback provisions, is equally applicable under the 1939 and 1954 Codes and indicates that Stauffer New Mexico was entitled to carry back its losses.

3. The only case authorities in point, *Pridemark*[2] and *Davant,*[3] directly support Petitioner's contentions herein.

4. Other than in the cases at bar and *Associated Machine,* which is also on appeal to this Court, Respondent has consistently advocated a broad interpretation of the "F" reorganization provisions.

5. Rev. Rul. 58-422,[4] like the cases at bar, involved an amalgamation of three corporations by means of a single statutory merger, and yet Respondent ruled therein that the merger involved an "F" reorganization.

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[1] *Libson Shops, Inc. v. Koehler* (1957) 353 U.S. 382.

[2] *Pridemark, Inc.* (1964) 42 T.C. 510, modified on other grounds (4th Cir. 1965), 345 F.2d 35.

[3] *Davant v. Commissioner,* sub. nom. *South Texas Rice Warehouse Co.,* (1965) 43 T.C. 540, aff'd. in part and rev'd. in part (5th Cir. 1966) 366 F.2d 874, cert. den. 386 U.S. 1022.

[4] 1958-2 C.B. 145.

II.

Respondent Cannot Distinguish Pridemark and Davant, or Rev. Rul. 58-422.

In attempting to avoid the impact of these fundamental concessions, Respondent asserts that he was in error in arguing in the *Pridemark* and *Davant* cases that an "F" reorganization had occurred and that the Courts were misled into accepting his arguments. We submit, however, that since the arguments advanced by the taxpayers in *Pridemark* and *Davant* are substantially the same as those advanced by Respondent herein,[5] the courts deciding *Pridemark* and *Davant* had adequate opportunity to consider fully and then reject the arguments Respondent presses herein.

Respondent then argues, with respect to Rev. Rul. 58-422, *supra,* that although an amalgamation of a parent and its two subsidiaries into a new corporation constitutes an "F" reorganization as to the parent and the new corporation, an amalgamation of three brother-sister corporations is in some way a different kind of amalgamation and therefore cannot qualify as an "F" reorganization as to any of the participants. The issue with respect to the meaning of Rev. Rul. 58-422 is, of course, primarily relevant to an alternative argument of Petitioner herein; namely, that the reincorporation of Stauffer California alone constitutes an "F" reorganization under the principles enunciated in Rev. Rul. 58-422. However, Respondent's arguments in attempting to distinguish Rev. Rul. 58-422 so effectively refute his own position in opposition to Petitioner's primary contention that Petitioner feels that the most logical approach in this Reply Brief is to first address herself

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[5]This is evident from an extract from the Government's brief before the Fourth Circuit in *Pridemark, Inc.* set out in Appendix A hereto.

to Respondent's contentions with respect to Rev. Rul 58-422.

Starting on page 40 of his Brief, Respondent attempts to distinguish Rev. Rul. 58-422 by focusing upon the final sentence of Section 332(b) of the Code; that sentence, by its terms, does not pertain to the liquidation of 100% owned subsidiaries such as the subsidiaries involved in Rev. Rul. 58-422, but expressly applies only where the parent corporation does not own all of the shares of the liquidated subsidiary. The meaning of the sentence is that a liquidation under Section 332 can occur even though minority shareholders are involved, and if the transaction is cast in the form of a reorganization the minority shareholders can receive the tax-free treatment. This is made clear in Treasury Regulations, § 1.332-2(d), cited by Respondent.

Even assuming Respondent's understanding of Section 332 were correct, this would not alter the simple fact that an amalgamation of three existing corporations into a newly formed corporation was involved in Rev. Rul. 58-422, and it is self-evident that the legal effect of the transactions considered in that ruling remains precisely the same whether the amalgamation of the subsidiaries is deemed to be a reorganization or liquidation. The effect of the amalgamation of three corporations considered in Rev. Rul. 58-422 was the same as the amalgamation of three corporations in the cases at bar, and the two amalgamations were accomplished in precisely the same manner.

Another perplexing aspect of Respondent's position with respect to Rev. Rul. 58-422 is his conclusion that "since there were two [*sic*—three] transactions the mere fact that they were consummated simultaneously in time does not alter their separate individual character." (Resp. Br., p. 42). This, of course, is the

very point of Petitioner's argument in her Opening Brief with respect to Rev. Rul. 58-422. In one breath Respondent states that the simultaneous statutory merger in Rev. Rul. 58-422 does not alter the separate individual character of the component transactions; yet in the next breath, he contends to the contrary in the cases at bar, stating that "there was a unitary agreement in which each step was made legally interdependent upon the other; and there was no intention evidenced, subjectively or objectively, that Stauffer California alone should undergo an "F" reorganization and retain its tax identity." (Resp. Br., p. 43). Respondent's contention is baffling since both Rev. Rul. 58-422 and the cases herein involved one simultaneous statutory merger, and thus the steps were identically interdependent in the two cases. The distinction which Respondent purports to see must therefore rest upon the absence of evidence of intention. This is, indeed, a novel construction of the law. Detailed examination of Respondent's arguments confirms Petitioner's assertions in her Opening Brief that Respondent views tax consequences under Section 368(a)(1)(F) as depending upon whether or not the taxpayer announces beforehand that a transaction is intended to be an "F" reorganization (Pet. Br., p. 53). Clearly, however, there is no requirement in the law that a taxpayer seek a prospective ruling from the Internal Revenue Service or announce its "intention" in some other way.

Turning now to the significance of Rev. Rul. 58-422 with respect to the primary argument of Petitioner herein—that the entire amalgamation constituted an "F" reorganization—Petitioner pointed out in her Opening Brief (Pet. Br., p. 51) that the holding in Rev. Rul. 58-422 had the effect of permitting all post-merger operating losses incurred by the successor corporation

to be carried back against the pre-merger profits of the parent irrespective of whether these operating losses were generated by the business formerly conducted by the parent or the businesses formerly conducted by the subsidiaries. Notwithstanding this obvious result of Rev. Rul. 58-422, Respondent, in replying to Petitioner's primary arguments herein, asserts that "it is apparent that Congress infused into the 1954 Code the single business enterprise theory that was adopted by the Supreme Court in *Libson Shops, supra,* and the First Circuit in *Newmarket Manufacturing Co. v. United States,* 233 F.2d 493" (Resp. Br., p. 27). This statement by Respondent is particularly perplexing and demonstrates the inconsistency of Respondent's arguments herein. In the first place, it is readily apparent that the holding in Rev. Rul. 58-422 is broader than the "single business enterprise theory" adopted by the Supreme Court in *Libson Shops* and the First Circuit in *Newmarket Manufacturing Co.* Under the theory of those cases, post-merger losses could only be carried back against the pre-merger income of the same business which produced the losses. However, under Rev. Rul. 58-422, the post-merger losses of all of the businesses of the three predecessor corporations can be carried back against the pre-merger income of the parent corporation, and this is a correct holding under the 1954 Code.[6]

While the "single business enterprise theory" is a narrower concept than that employed in Rev. Rul. 58-422, the "single business enterprise theory" does constitute the basis of Petitioner's third alternative argu-

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[6]As pointed out in Petitioner's Opening Brief (p. 24, fn. 8), this Court has specifically held that the "single business enterprise theory" is not applicable under the 1954 Code as to loss carryovers. *Maxwell Hardware Co. v. Commissioner* (9th Cir. 1965), 343 F.2d 713.

ment advanced in her Opening Brief; namely, that if this Court were to reject the holdings in *Pridemark* and *Davant, supra,* and also reject the holdings of Rev. Rul. 58-422, then the "single business enterprise theory" of *Libson Shops* should be applied so as to treat the three mergers as three separate "F" reorganizations. (Pet. Br., p. 60). The effect of this would be that the carry-back of post-merger losses would be permitted to the extent of the pre-merger income of the same business which produced the losses. This was the rule under the 1939 Code. See Rev. Rul. 59-395, 1952-2 C.B. 475, discussed at length in Petitioner's Brief, pp. 47-49. As pointed out in Petitioner's Opening Brief (Pet. Br., pp. 60-61), Petitioner introduced sufficient evidence before the Tax Court to establish the tracing of pre-merger income and post-merger losses (and Respondent does not deny this).

The admission by Respondent that the philosophy of *Libson Shops* and *Newmarket Manufacturing Co.* is applicable under the 1954 Code is extremely significant since these cases epitomize Petitioner's assertion in her Opening Brief that the efforts of the courts in recent years, and of the Congress in adopting the 1954 Code, have been to make economic realities rather than corporate artificialities determinative of the availability of loss carryovers and carrybacks. The *Libson Shops* case, of course, has already been discussed at some length by Petitioner. See pp. 20-25 of Petitioner's Opening Brief, and particularly pp. 24-25. As to *Newmarket Manufacturing Co.,* the rationale of that decision was carefully explained by that Court in its later decision of *F. C. Donovan, Inc. v. U. S.* (1st Cir. 1960), 261 F.2d 470, discussed in Petitioner's Opening Brief (Pet. Br., p. 64, fn. 23), in which the First Circuit made it clear that its decision in *Newmarket*

Manufacturing Co., far from being favorable to Respondent herein, fully supports Petitioner's position herein.

Respondent's summary of its position with respect to Rev. Rul. 58-422 (Resp. Br., pp. 42-43), and Petitioner's responses thereto, are as follows:

1. Respondent's contention: "First, the liquidation of the two subsidiaries is a separate transaction (under Section 332) from the reorganization of the parent."

Response: Similarly, we submit, the reorganizations of Stauffer New York and Stauffer Illinois constitute transactions separate from the reorganization of Stauffer California.

2. Respondent's contention: "Second, since there were two transactions the mere fact that they were consummated simultaneously in time does not alter their separate individual character."

Response: This, of course, Petitioner agrees with. Similarly, the fact that the transactions in the cases at bar were consummated simultaneously does not alter their separate character in the cases at bar. In the recent Tax Court case of *Dunlap & Associates, Inc.* (1967), 47 T.C. 542, discussed on pp. 28-30 of Petitioner's Opening Brief, the Tax Court followed this approach.[7]

3. Respondent's contention: "Third, a comparison with a situation in which the two transactions are separated in time indicates that the liquidation of the subsidiaries does not destroy a subsequent reincorporation of the parent."

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[7]Respondent attempts to distinguish *Dunlap* on the ground that there was no express provision in the documents that the transactions were legally conditioned upon the other (Resp. Br., p. 40, fn. 20). However, it is evident that the decision of the Court did not rest upon this formalistic nicety.

Response: Similarly, it is undisputed that in the cases at bar the loss carryback would have been available to Stauffer New Mexico if the transactions had been separated in time (Pet. Br., p. 18).

4. Respondent's contention: "Fourth, there is no reason why the liquidation should do so when it is consummated simultaneously with an "F" reorganization."

Response: This, of course, Petitioner agrees with, and this reasoning is equally applicable to the cases at bar. The Tax Court adopted this approach in its recent decision of *Casco Products Corp.* (1967), 49 T.C. No. 5, (Pet. Br., pp. 26-28).[8]

Thus, Respondent's arguments in attempting to rationalize the ruling in Rev. Rul. 58-422 merely operate to confirm Petitioner's contention that Rev. Rul. 58-422 governs the cases at bar. Moreover, although Respondent alleges that the "single business enterprise theory" should be applicable under the 1954 Code, the holding in Rev. Rul. 58-422 is itself incompatible with the "single business enterprise theory." Furthermore, Respondent ignores the fact that Petitioner has satisfied the "single business enterprise theory", and that this theory formed the basis of Petitioner's second alternative contention in her Opening Brief.

[8]Respondent attempts to distinguish the *Casco Products* case by alleging that the case involved a redemption and not a reorganization. However, the whole point of the holding is that even though a merger had occurred, the Court would look to the substance rather than the form of the transaction and treat the transaction as if a redemption had occurred, thus permitting the post-merger losses to be carried back against pre-merger income.

III.

Respondent Cannot Support His Contention That Existing Law as to the Nature of an "F" Reorganization Should Be Overruled.

Turning now to Respondent's contentions with respect to the primary arguments advanced by Petitioner, these contentions and Petitioner's responses thereto, may be summarized as follows:

1. Respondent's contention: Petitioner's assertion that the touchstone of an "F" reorganization is continuity of ownership and business "would for all practical purposes erase any meaningful difference between an "A" and an "F" reorganization . . ." (Resp. Br., p. 14) and that "continuity of ownership and business enterprise is . . . true of every tax-free reorganization defined by Section 368(a)(1)." (Resp. Br., p. 18.)

Response: This, of course, is not so. The typical reorganization (whether type "A", "B" or "C") occurs between two unrelated entities, and clearly lacks the total continuity necessary for an "F" reorganization. The reorganizations in the cases at bar obviously are distinguishable inasmuch as they involve complete identity of ownership.

2. Respondent's contention: The examples in the explanatory Senate Finance Committee Report and the Treasury Regulations are inconsistent with Petitioner's contentions herein (Resp. Br., pp. 26-27).

Response: The very passage quoted by Respondent refutes his own position. After giving several examples involving the merger of unrelated corporations, the quoted passage goes on to qualify the result it arrived at under the facts of these examples by stating that if the transaction in question constitutes an "F" reor-

ganization, the carryback of post-merger losses is permissible. The quoted language does not in any way address itself to whether the statutory merger of the three identically owned corporations qualifies as an "F" reorganization.

3. Respondent's contention: The meaning of Section 381(c)(1)(A) is that "the acquiring corporation may not carry back the transferor's net operating loss to any of its pre-reorganization taxable years." (Resp. Br., p. 28).

Response: Section 381(c)(1)(A) expressly applies only to net operating loss carryovers and not net operating loss carrybacks, and thus is wholly irrelevant to loss carrybacks. Section 381(b) governs the right of the acquiring corporation to carry back losses.

4. Respondent's contention: A mechanical problem may arise if the carryback is permitted in those instances where the predecessor corporations were on different fiscal periods (which was not true in the cases at bar). (Resp. Br., pp. 29-31).

Response: This is by no means the only mechanical problem not contemplated by Congress in drafting Section 381. As pointed out in Petitioner's Opening Brief (p. 63), Congress could not have been expected to contemplate all permutations and combinations which would arise from such a complex statutory scheme, and the Regulations have in various instances attempted to bridge the gaps in the legislative scheme. For example:

(a) Congress did not provide in Section 381 for the possbility that more than one "acquiring corporation"

could be involved in a tax-free reorganization (see, Section 368(a)(2)(C) of the Code). Accordingly, the Regulations under Section 381 had to develop a set of "arbitrary" rules as to which corporation should be deemed to be the acquiring corporation where multiple acquiring corporations are involved (see Regs. §§ 1.381 (a)-1(b)(2), 1.381(c)(2)-1(d), 1.381(c)(14)-1(e)).

(b) Congress did not provide for the possibility of multiple successive reorganizations, and accordingly the Regulations had to develop an elaborate network of "arbitrary" rules governing this possibility (see Regs. §§ 1.381(c)(1)-1(g),(h), 1.381(c)(1)-2, 1.381(c)(3)-1(f), 1.381(c)(6)-1(f), 1.381(c)(14)-1(d), 1.381(c)(15)-1(b), 1.381(c)(17)-1(e), 1.381(c)(21)-1(c)).

5. Respondent's contention: If Petitioner's position is correct, then "divisive" reorganizations must similarly qualify as "F" reorganizations (Resp. Br., p. 22).

Response: Perhaps the most intriguing aspect of this argument is how the Government will react if, in the typical "liqudation-reincorporation" situation (see Pet. Br., p. 34, fn. 11), the taxpayer reincorporates in two corporations rather than one. Such a situation will clearly not constitute a "D" reorganization (unless the requirements of Section 355 are met), and if the "F" reorganization provisions are not invoked, tax avoidance will be possible through the use of that reincorporation mechanism. Putting aside question as to how Respondent will react when the shoe is on the other

foot, it is evident that a holding herein that the mergers constitute an "F" reorganization would not extend to divisive reorganizations coming within the ambit of Section 355 of the Code. A Section 355 transaction (which may or may not be a reorganization) involves a distribution by a parent corporation of stock in a subsidiary corporation to the shareholders of the parent corporation. Said shareholders thereby become direct owners of the subsidiary corporation, and this, in turn, affords them tax avoidance opportunities which Section 355 restricts. Thus, such a divisive transaction is more than a mere change in identity or form, and, accordingly, if it is a reorganization, it is controlled by the "D" reorganization provisions (see, *e.g.*, Sections 368(a)(1)(D) and 354(b)). On the other land, if the divisive transaction does not qualify under Section 355, *e.g.*, the "liquidation-reincorporation" example used above, the "F" reorganization provisions might be invoked to preclude the tax avoidance which would otherwise be possible. See discussion, Bittker & Eustice, *Federal Income Taxation of Corporations and Shareholders*, (2d Ed. 1966) at pp. 494-5.

6. Respondents contention: The scheme of the reorganization provisions and the language and history of Section 368(a)(1)(F) indicate that the "F" provision is limited to formalistic changes in a single corporate enterprise (Resp. Br., p. 21).

Response: Petitioner regards this contention by Respondent as particularly erroneous, since this argument is diametrically contrary to the holdings in *Pride-*

mark and in *Davant.* Of course, in those cases it was the taxpayers who argued, albeit unsuccessfully, the very points which Respondent has now adopted as his own in the cases at bar. Indeed, Respondent so thoroughly embraces this argument in his Brief that he carries the argument to the extreme of stating that "[c]onsidered in its context, that language [*i.e.,* the definition of an "F" reorganization] simply means a reincorporation (a new charter) in the same or another state and no more." (Resp. Br., p. 21). It seems apparent, however, that if Congress intended that the language simply meant a reincorporation, Congress would have limited the definition of an "F" reorganization to a reincorporation; and obviously Congress did not. It is equally obvious that Congress had in mind much more than a mere reincorporation when it included a "change in . . . form, . . . however effected" in the definition of an "F" reorganization, since the word "form" has a special meaning arising from the "form vs. substance" distinction when used in the tax law.

In support of his position on the scope of "F" reorganizations, Respondent relies upon Bittker & Eustice, *Federal Income Taxation of Corporations and Shareholders,* (2d Ed. 1966). However, Respondent fails to call the Court's attention to the most recent comments on the subject in that publication, wherein the authors state as follows (1968 Supp. No. 1, pp. 40-41):

> "In two major recent government victories on the reincorporation issue, the Fifth Circuit adopted essentially the approach of Rev. Rul. 61-156,

finding both a D reorganization *and* an F reorganization: Davant v. Commissioner, 366 F.2d 874, 18 AFTR 2d 5523 (5th Cir. 1966); Reef Corp. v. Commissioner, 368 F.2d 125, 18 AFTR 2d 5832 (5th Cir. 1966). * * *

"But the Service's use of the F reorganization in the reincorporation area received a sharp setback in two recent Tax Court decisions: Est. of B. Stauffer, 48 T.C. 277 (1967); Associated Machine, 48 T.C. 318 (1967). There it was held that §368(a)(1)(F) was limited to fairly nominal changes in the structure of a *single* corporation, and did not apply to the instant cases, which involved the fusion of several brother-sister corporations. The Tax Court also overruled its earlier decision in the *Pridemark* case, which had found an F reorganization in a multiple corporate fusion situation; in addition, it refused to follow *Davant*."

It is apparent that the authors of that publication regard the decision of the Tax Court below in the cases at bar as unsound, inconsistent with Respondent's otherwise uniform position, and detrimental to the interests of the Government because of the opportunities it affords for taxpayer abuses in the "liquidation-reincorporation" area. See, generally, Bittker & Eustice, *supra,* at p. 569 *et seq.*

In Petitioner's Opening Brief, the posture of the law and of Respondent's position as to the broad scope of the "F" reorganization provisions was extensively treated (Pet. Br., pp. 33-36), and accordingly will not be repeated here. However, it is again respectfully submitted that Respondent's arguments here are totally in-

consistent with those he has made elsewhere on the scope of the "F" reorganization provisions.

Inasmuch as all authorities in the income tax area support Petitioner's contentions herein, Respondent was driven to look elsewhere for support of his contentions as to the narrow scope of the "F" reorganization provisions, and he has chosen to rely upon two documentary stamp-tax cases, *Cabot Corp. v. United States,* (D. Mass. 1963), 220 F. Supp. 261; aff'd *per curiam* (1st Cir. 1964), 326 F.2d 753; and *Columbia Gas of Maryland, Inc. v. United States,* (Ct. Cl. 1966), 366 F.2d 991. Both of these cases involved only the interpretation of the documentary stamp-tax provisions of the law and therefore are not relevant to this proceeding. It is interesting to note, however, that although the Court in *Cabot* held that the transaction did not constitute an "F" reorganization within the meaning of the documentary stamp act provisions, nonetheless it was undisputed by the parties that the transaction did constitute an "F" reorganization for purposes of the income tax law. Indeed, the taxpayer in the *Cabot* case had secured a ruling to this effect from the Internal Revenue Service. The *Cabot* case involved a parent corporation, two wholly-owned subsidiaries, and a third subsidiary which was 95% owned. The transactions in question in the *Cabot* case were strikingly similar as those in the cases at bar; namely, a new corporation was formed in another state, and the predecessor parent corporation and its three subsidiaries were simultaneously merged into the new corporation. The Internal Revenue Service ruled (in accordance with Rev.

Rul. 58-422, *supra*) that this amalgamation of the four predecessor corporations was (i) an "F" reorganization of the parent corporation, (ii) an "A" reorganization (statutory merger) of the 95% owned subsidiary so far as the minority shareholders of that subsidiary were concerned, and (iii) a Section 332 liquidation of the subsidiaries so far as the parent corporation was concerned. A full copy of that ruling, as set forth in the taxpayer's Brief before the First Circuit in *Cabot,* is set out in Appendix B hereto. In view of that ruling, it is perplexing how Respondent can rely upon the *Cabot* case. In fact, *Cabot* completely refutes Respondent's arguments herein, as to both Respondent's rejection of Petitioner's primary arguments herein and Respondent's rejection of the applicability of Rev. Rul. 58-422. *Cabot* involved the very things which Respondent here asserts cannot give rise to an "F" reorganization; namely:

(a) An amalgamation of multiple corporations in one simultaneous merger.

(b) A statutory merger constituting an "A" reorganization, separate and independent of any "F" reorganization that may have otherwise been involved.

Columbia Gas was a split 3 to 2 decision, involving a divisive reorganization which, as heretofore observed, is manifestly distinguishable from the cases at bar. Moreover, the Court was only concerned with the interpretation of an exemption from the documentary stamp taxes, holding that the exemption should be narrowly construed.

THE "ERRONEOUS ASSESSMENT" ISSUE.

I.

Neither Stauffer New Mexico nor the Petitioner Has Transferee Liability With Respect to the Refund Made.

With respect to the money refunded to Stauffer New Mexico, Respondent's reply can best be analyzed by restating Petitioner's three arguments:

1. Stauffer New Mexico did not purport to file a refund claim on behalf of Stauffer California.

2. Stauffer New Mexico could not possibly have filed a refund claim on behalf of Stauffer California under the applicable statute, Section 381(b)(3), since that section of the Code clearly and expressly gives the right of carryback, not to Stauffer California, but to Stauffer New Mexico.

3. In order to hold Petitioner liable as a transferee, Stauffer New Mexico must itself be a transferee, which it is not, since there was no obligation of Stauffer California, choate or inchoate, existent on the date of merger.

In response to Petitioner's first argument, Respondent asserts (Resp. Br., p. 45) that it has the right to waive the "formal" requirement that Stauffer New Mexico state in its claim for refund that it was acting on behalf of Stauffer California. That, however, is not the point at all. The point is that Stauffer New Mexico did not act, and did not intend to act, on behalf of Stauffer California.

As to Petitioner's assertion that Section 381(b)(3) specifically gives the right to refund to Stauffer New Mexico and not Stauffer California, Respondent merely asserts that Stauffer New Mexico, under the statute, has only a "procedural right" to claim the refund. This

is neither what the statute says nor what the statute means. The right to a refund vested in Stauffer New Mexico, and not Stauffer California.

As to Petitioner's third point that there could not have possibly been transferee liability in Stauffer New Mexico for the tax refund, Petitioner argues two points:

(a) Stauffer New Mexico admitted its obligation as transferee for any deficiencies in the tax of Stauffer California (Resp. Br., p. 47).

(b) In any event, it is not necessary for Stauffer New Mexico to have transferee liability, since Stauffer New Mexico is primarily liable for any deficiency in Stauffer California's taxes.

The first fallacy in both these assertions is in the assumption that the tax refund constituted a deficiency of Stauffer California; this assumes the very point in issue. The refund to Stauffer New Mexico is not a deficiency in Stauffer California's taxes; it is a refund granted to Stauffer New Mexico as a result of operating losses incurred by Stauffer New Mexico after the merger occurred.

The second fallacy is Respondent's assertion that Stauffer New Mexico admitted its obligation for any deficiencies in the tax of Stauffer California. The relevant language of Form 2045, upon which Respondent relies, is quoted in full text on p. 9 of his Brief, but is only quoted in partial text on p. 47 of his Brief where he discusses the point. The crucial language which Respondent failed to quote on p. 47 of his Brief states that Stauffer New Mexico's agreement to assume and pay taxes of Stauffer California is expressly limited as follows:

> ". . . to the extent of its liability at law or in equity, as a transferee within the meaning of Sec-

> tion 6901 of the Internal Revenue Code of 1954 and corresponding provisions of prior internal revenue laws. . . ."

In short, Stauffer New Mexico by executing Form 2045 agreed only to pay such amounts as it was liable for as a transferee within the meaning of Section 6901 of the Code.[9]

In order for Stauffer New Mexico to be liable as a transferee of Stauffer California, Section 6901 of the Code requires that Stauffer California must have incurred the liability at law or in equity as of the date of merger of Stauffer California into Stauffer New Mexico. Obviously, there was no liability of Stauffer California for unpaid taxes, choate or inchoate, existent on the date of merger, since the refund that produced the alleged deficiency arose out of losses suffered by Stauffer New Mexico long after the date of merger. The posture of this proceeding is similar to the situation in *Yagoda* (1962) 39 T.C. 170, aff'd. (2nd Cir. 1964) 331 F.2d 485, acq. 1963-2 C.B. 5. In *Yagoda* the Government sought to establish transferee liability against a trust beneficiary based upon trust taxes which had erroneously been refunded after the trust had been terminated. The Tax Court held that the taxpayer was not liable as a transferee of the trust, since the tax deficiency caused by the refund was not an existing debt

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[9]At p. 47 of its Brief, Respondent cites *Commissioner v. Newport Industries, Inc.* (7th Cir. 1941), 121 F.2d 655, for the proposition that it is not necessary for Stauffer New Mexico to be a transferee. However, in that case the successor corporation specifically admitted its liability as transferee for the deficiency in question (see 121 F.2d at 655), and the issue was whether the deficiency was proper. Moreover, the deficiency therein arose out of facts occurring prior to the dissolution of the predecessor corporation, and thus is readily distinguishable from the cases at bar.

of the trust at the time the trust was terminated. The Court stated as follows (at p. 185):

> "The liability which the Commissioner now asserts arises because of the subsequent erroneous overassessment. To be sure, the trust has again become liable for 1944 taxes; but that liability, in the peculiar context of this case, is the consequence of events which transpired long after Lena became a transferee. * * *"

Conclusion.

Respondent has demonstrated no reason why existing law should be ignored and the taxpayer penalized as a result of reincorporating three corporations at the same time. The difficulties which Respondent purports to see are largely illusory, and to the extent they are existent, are no less susceptible of administrative solution than a multitude of other difficulties involved in applying the revenue laws. The very purpose of the loss carryback provisions would be frustrated if taxpayer were deemed to have forfeited the right to carry back these losses merely because the change in place of incorporation and merger were consummated at the same time, and the ability of the Government to defend against the "liquidation-reincorporation" tax avoidance device would be seriously jeopardized by adoption of Respondent's arguments.

In any event, it is evident that the "erroneous refund" applied for and received by Stauffer New Mexico is not properly an element of the deficiency of Stauffer California.

Respectfully submitted,

Gibson, Dunn & Crutcher,
Norman B. Barker,
Attorneys for Petitioner.

Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Norman B. Barker

APPENDIX A.

Extract from pp. 46-47 of taxpayer's brief before the Fourth Circuit in Pridemark, Inc. See footnote 5.

"The Tax Court held (R. 29, 35-36) that the 1958 and 1959 transactions 'clearly fall within both the letter and the intent of section 368(a)(1)(F) of the 1954 Code, * * *' A type F reorganization is defined as a 'mere change in identity, form, or place of organization, however effected.' The Tax Court states (R. 31) that this language is broadly phrased. The gist of the taxpayers' contention to the contrary (Br. 48), that a type F reorganization 'is the narrowest of the reorganization definitions', apparently is based upon their view that this type of reorganization is limited to a reincorporation in another jurisdiction. Such an interpretation eliminates from the definition the term, change of form. . . .' * * *

"Moreover, the taxpayers are not correct in their analysis (Br. 48-49) of the legislative history of the type F reorganization. Practically identical language to that now employed first appeared in Section 202(c)(2) of the Revenue Act of 1921, c. 136, 42 Stat. 227, and has remained substantially the same in all the succeeding tax statutes. Randolph Paul, in Studies in Federal Taxation (Third Series, 1940), pp. 22-23, 23-30, 81-82, indicates that while this provision may have originated to insure that a mere reincorporation in another state should not constitute a taxable event, this provision probably also was intended as a catch-all for cases not covered by other definitions. * * *"

APPENDIX B.

Ruling Letter.

(Seal)

U. S. TREASURY DEPARTMENT
Internal Revenue Service
Washington 25, D. C.

May 9 1961

Godfrey L. Cabot, Inc.
125 High Street
Boston 10, Massachusetts

Attention: Mr. Arthur H. Phillips
General Counsel

Gentlemen:

This is in reply to the letter dated July 25, 1960, in which a ruling is requested as to the Federal income tax consequences of the transactions the relevant facts of which are summarized hereinafter. Additional information was submitted in a letter dated September 22, 1960.

On the date of the request for ruling, Godfrey L. Cabot, Inc., ("Cabot") was a Massachusetts corporation which was engaged, largely through subsidiaries, in the manufacture and sale of carbon black, gas, oil, oil field pumping and drilling equipment, gun tubes, miscellaneous chemicals and certain other products. Cabot had outstanding 81,778 shares of no par value common stock.

On the date of the request for ruling, Cabot owned all of the outstanding stock of Cabot Shops, Inc.

("Shops"), and Cabot Gasoline Corporation ("Gasoline"), and 58,759 of the 61,900 outstanding shares of common stock of Cabot Carbon Company ("Carbon").

Carbon was a Massachusetts corporation engaged in the manufacture and sale of carbon black, oil and gas, and certain chemicals. Shops was a Massachusetts corporation engaged in the manufacture and sale of oil field pumping and drilling equipment and gun tubes. Gasoline was a Massachusetts corporation engaged in the production of butane, propane, natural gasoline and residue gas.

It was believed that substantial reductions in operating expenses could be achieved by reincorporating Cabot in Delaware. It was believed that additional savings could be made if Carbon, Shops and Gasoline were merged into Cabot.

Accordingly, Cabot Corporation ("Company") was incorporated in Delaware on July 14, 1960, and Cabot, Carbon, Shops and Gasoline were merged into it pursuant to the Delaware Corporation Law and the Massachusetts General Laws. The shareholders of Cabot received 30 shares of $1 par value common stock in Company in exchange for each share of Cabot outstanding immediately prior to the merger. The shares of Carbon owned by Cabot were cancelled and the balance of the Carbon stock was exchanged for Company stock in the ratio of 24 shares of Company for each share of Carbon stock held by the minority shareholders. The shares of stock of Shops and Gasoline were cancelled

and the 1,000 shares of Company stock issued and outstanding prior to the mergers were retired.

Based solely on the facts presented it is held as follows (all section references are to the Internal Revenue Code of 1954):

1. The merger of Cabot into Company was a mere change in place of organization and constituted a reorganization within the meaning of section 368(a)(1)(A) and (F), provided all of the requirements of the statutes of Delaware and Massachusetts permitting such merger were met. No gain or loss is recognized to Cabot as a result of the merger.
2. The merger of Carbon, Shops and Gasoline into Company, as outlined above, constituted in each instance, the complete liquidation of a subsidiary within the meaning of section 332(b). Under the provisions of section 332(a), no gain or loss is recognized to Company as a result of the liquidations. Pursuant to section 336, no gain or loss is recognized to Carbon, Shops or Gasoline.
3. As to the minority shareholders of Carbon, the merger of Carbon into Company constituted a reorganization within the meaning of section 368(a)(1)(A), provided all of the requirements of the statutes of Delaware and Massachusetts permitting such a merger were met.
4. In accordance with the provisions of section 354(a), no gain or loss is recognized to the shareholders of Cabot or to the minority shareholders of Carbon as a result of the exchange by them of common stock of Cabot and/or Carbon for common stock of Company.

5. Immediately after the transactions described above, the basis and holding period of the stock of Company received by each shareholder of Cabot and each minority shareholder of Carbon were the same as the basis and holding period of the stock exchanged therefor (sections 358(a) and 1223).
6. Immediately after the transactions described above, the bases and holding periods of the properties received by Company were the same as the bases and holding periods of those properties in the hands of Cabot, Carbon, Shops and Gasoline immediately prior to the transactions (sections 362(b), 334(b)(1) and 1223).
7. No gain or loss is recognized to Company as a result of the transactions ruled upon in the above ruling paragraphs (section 1032(a)).

Pursuant to the letter from Mr. Henry B. Jordan dated April 10, 1961, the rulings with respect to the transfer taxes payable on the transactions described above will be made the subject of a separate communication.

It is important that a copy of this letter be attached to the Federal income tax returns of Cabot, Carbon, Shops, Gasoline and Company for the taxable year in which the transaction took place.

Pursuant to the power of attorney on file in this office, a copy of this letter is being sent to Mr. Paul D. Yager.

Very truly yours,

Glen Paschall

Chief, Reorganization Branch